Test ID: 32025523

Question #1 of 60

Question ID: 691493

Questions 61-66 relate to Mike Zonding.

Mike Zonding, CFA, is conducting a background check on CFA candidate Annie Cooken, a freshly minted MBA who applied for a stock-analysis job at his firm, Khasko Financial. Zonding does not like to hire anyone who does not adhere to the Code and Standards' professional conduct requirements.

The background check reveals the following:

i. While doing a full-time, unpaid internship at Kale Investments, Cooken was reprimanded for working a 30-hour-a-week night job as a waitress.
ii. As an intern at Lammar Corp., Cooken was fired after revealing to the FBI that one of the principals was embezzling from the firm's clients.
iii. Cooken performed 40 hours of community service in relation to a conviction on a misdemeanor drug possession charge when she was 16 years old.
iv. On her resume, Cooken writes, "Recently passed Level II of the CFA exam, a test that measures candidates' knowledge of finance and investing."

During the interview, Zonding asks Cooken several questions on ethics-related issues, including questions about the role of a fiduciary and Standard III(E) Preservation of Confidentiality. He asks her about her internship at Kale Investments, specifically about the working hours. Cooken replies that the internship turned out to require more time than she originally planned, up to 65 hours per week.

Zonding subsequently hires Cooken and functions as her supervisor. On her third day at the money management boutique firm, portfolio manager Steven Clarrison hands her a report on Mocline Tobacco and tells her to revise the report to reflect a buy rating. Cooken is uncomfortable about revising the report.

To supplement the meager income from her entry-level stock-analysis job, Cooken looks for part-time work. She is offered a position working three hours each Friday and Saturday night tending bar at a sports bar and grill downtown. Cooken does not tell her employer about the job.

During her first week, Cooken has lunch with former MBA classmates, including Taira Basch, CFA, who works for the compliance officer at a large investment bank in town. Basch arrives late, explaining, "What a day, it's only noon and already I have worked on the following requests:

1. A federal regulator called and wanted information on potentially illegal activities related to one of the firm's key clients.
2. A rival company's employee wanted information regarding employment opportunities at the firm.
3. A potential client contacted an employee and wanted detailed performance records of client accounts so he can decide whether to invest with the firm."

Zonding appeared on a financial news network program to discuss Orlando Stores, a discount clothing chain. Khasko's investment banking department has completed transactions for Orlando in the past 12 months and currently is working with Orlando to conduct a secondary offering; Khasko has a policy in place that separates the activities of investment banking and

research.

At the beginning of the interview, Zonding disclosed that Khasko has an investment banking relationship with Orlando Stores and that his wife holds Orlando shares. He also stated that his research is available on Khasko's website, although he forgot to comment on the risk profile and suitability of investing in Orlando shares.

The host asked Zonding to comment on Khasko's outlook for the stock, given Orlando's recently announced expansion plans. Zonding stated that he officially had a 12-month buy rating on the stock, though he is concerned about potential oversaturation in some of Orlando's markets. When asked about his conviction level in his buy rating, Zonding replied that if there is a sharp share price increase next week when earnings are released, viewers should take the opportunity to sell shares since there are always long-term risks inherent in expansion. Zonding also mentioned that he did not want to be negative about Orlando shares since Orlando is a valuable client of Khasko.

....

In the context of the Code and Standards, which of the items from the background check would *most likely* indicate that Zonding should not have hired Cooken?

A) Item i.

B) Item ii.

C) Item iii.

Question #2 of 60

Question ID: 691494

Mike Zonding, CFA, is conducting a background check on CFA candidate Annie Cooken, a freshly minted MBA who applied for a stock-analysis job at his firm, Khasko Financial. Zonding does not like to hire anyone who does not adhere to the Code and Standards' professional conduct requirements.

The background check reveals the following:

i. While doing a full-time, unpaid internship at Kale Investments, Cooken was reprimanded for working a 30-hour-a-week night job as a waitress.
ii. As an intern at Lammar Corp., Cooken was fired after revealing to the FBI that one of the principals was embezzling from the firm's clients.
iii. Cooken performed 40 hours of community service in relation to a conviction on a misdemeanor drug possession charge when she was 16 years old.
iv. On her resume, Cooken writes, "Recently passed Level II of the CFA exam, a test that measures candidates' knowledge of finance and investing."

During the interview, Zonding asks Cooken several questions on ethics-related issues, including questions about the role of a fiduciary and Standard III(E) Preservation of Confidentiality. He asks her about her internship at Kale Investments, specifically about the working hours. Cooken replies that the internship turned out to require more time than she originally planned, up to 65 hours per week.

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firm, portfolio manager Steven Clarkson hands her a report on Mocline Tobacco and tells her to revise the report to reflect a buy rating. Cooken is uncomfortable about revising the report.

To supplement the meager income from her entry-level stock-analysis job, Cooken looks for part-time work. She is offered a position working three hours each Friday and Saturday night tending bar at a sports bar and grill downtown. Cooken does not tell her employer about the job.

During her first week, Cooken has lunch with former MBA classmates, including Taira Basch, CFA, who works for the compliance officer at a large investment bank in town. Basch arrives late, explaining, "What a day, it's only noon and already I have worked on the following requests:

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At the beginning of the interview, Zonding disclosed that Khasko has an investment banking relationship with Orlando Stores and that his wife holds Orlando shares. He also stated that his research is available on Khasko's website, although he forgot to comment on the risk profile and suitability of investing in Orlando shares.

The host asked Zonding to comment on Khasko's outlook for the stock, given Orlando's recently announced expansion plans. Zonding stated that he officially had a 12-month buy rating on the stock, though he is concerned about potential oversaturation in some of Orlando's markets. When asked about his conviction level in his buy rating, Zonding replied that if there is a sharp share price increase next week when earnings are released, viewers should take the opportunity to sell shares since there are always long-term risks inherent in expansion. Zonding also mentioned that he did not want to be negative about Orlando shares since Orlando is a valuable client of Khasko.

....

Which of the following statements provides the *least appropriate* justification for Cooken's caution about revising the report on Mocline Tobacco?

A) Cooken knows next to nothing about Mocline stock.

B) Cooken's uncle, George Whates, is the CFO of Mocline.

C) In college, Cooken worked for Mocline but never declared the income on her taxes.

Question #3 of 60

Question ID: 691495

Mike Zonding, CFA, is conducting a background check on CFA candidate Annie Cooken, a freshly minted MBA who applied for a stock-analysis job at his firm, Khasko Financial. Zonding does not like to hire anyone who does not adhere to the Code and Standards' professional conduct requirements.

The background check reveals the following:

i. While doing a full-time, unpaid internship at Kale Investments, Cooken was reprimanded for working a 30-hour-a-week night job as a waitress.
ii. As an intern at Lammar Corp., Cooken was fired after revealing to the FBI that one of the principals was embezzling from the firm's clients.
iii. Cooken performed 40 hours of community service in relation to a conviction on a misdemeanor drug possession charge when she was 16 years old.
iv. On her resume, Cooken writes, "Recently passed Level II of the CFA exam, a test that measures candidates' knowledge of finance and investing."

During the interview, Zonding asks Cooken several questions on ethics-related issues, including questions about the role of a fiduciary and Standard III(E) Preservation of Confidentiality. He asks her about her internship at Kale Investments, specifically about the working hours. Cooken replies that the internship turned out to require more time than she originally planned, up to 65 hours per week.

Zonding subsequently hires Cooken and functions as her supervisor. On her third day at the money management boutique firm, portfolio manager Steven Clarrison hands her a report on Mocline Tobacco and tells her to revise the report to reflect a buy rating. Cooken is uncomfortable about revising the report.

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At the beginning of the interview, Zonding disclosed that Khasko has an investment banking relationship with Orlando Stores and that his wife holds Orlando shares. He also stated that his research is available on Khasko's website, although he forgot to comment on the risk profile and suitability of investing in Orlando shares.

The host asked Zonding to comment on Khasko's outlook for the stock, given Orlando's recently announced expansion plans. Zonding stated that he officially had a 12-month buy rating on the stock, though he is concerned about potential oversaturation in some of Orlando's markets. When asked about his conviction level in his buy rating, Zonding replied that if there is a sharp share price increase next week when earnings are released, viewers should take the opportunity to sell shares since there are always long-term risks inherent in expansion. Zonding also mentioned that he did not want to be negative about Orlando shares since Orlando is a valuable client of Khasko.

By not telling Zonding about the bartending position, Cooken has *most likely* violated:

A) no Standards.

B) Standard IV(B) Additional Compensation Arrangements.

C) Standard IV(A) Loyalty (to employer) and Standard IV(B) Additional Compensation Arrangements.

Question #4 of 60

Question ID: 691496

Mike Zonding, CFA, is conducting a background check on CFA candidate Annie Cooken, a freshly minted MBA who applied for a stock-analysis job at his firm, Khasko Financial. Zonding does not like to hire anyone who does not adhere to the Code and Standards' professional conduct requirements.

The background check reveals the following:

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iii. Cooken performed 40 hours of community service in relation to a conviction on a misdemeanor drug possession charge when she was 16 years old.
iv. On her resume, Cooken writes, "Recently passed Level II of the CFA exam, a test that measures candidates' knowledge of finance and investing."

During the interview, Zonding asks Cooken several questions on ethics-related issues, including questions about the role of a fiduciary and Standard III(E) Preservation of Confidentiality. He asks her about her internship at Kale Investments, specifically about the working hours. Cooken replies that the internship turned out to require more time than she originally planned, up to 65 hours per week.

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....

Which of the requests, if fulfilled, is *most likely* to place Basch in violation of Standard III(E) Preservation of Confidentiality?

A) Request 1.
B) Request 2.
C) Request 3.

Question #5 of 60

Question ID: 691497

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iv. On her resume, Cooken writes, "Recently passed Level II of the CFA exam, a test that measures candidates' knowledge of finance and investing."

During the interview, Zonding asks Cooken several questions on ethics-related issues, including questions about the role of a fiduciary and Standard III(E) Preservation of Confidentiality. He asks her about her internship at Kale Investments, specifically

fiduciary and Standard III(E) Preservation of Confidentiality. He asks her about her internship at Kale Investments, specifically about the working hours. Cooken replies that the internship turned out to require more time than she originally planned, up to 65 hours per week.

Zonding subsequently hires Cooken and functions as her supervisor. On her third day at the money management boutique firm, portfolio manager Steven Clarrison hands her a report on Mocline Tobacco and tells her to revise the report to reflect a buy rating. Cooken is uncomfortable about revising the report.

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During her first week, Cooken has lunch with former MBA classmates, including Taira Basch, CFA, who works for the compliance officer at a large investment bank in town. Basch arrives late, explaining, "What a day, it's only noon and already I have worked on the following requests:

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....

Was Zonding in compliance with regard to CFA Institute Research Objectivity Standards (ROS) recommendations on public appearances?

A) No, because Zonding neglected to discuss Orlando's suitability as an investment.

B) No, because Zonding failed to disclose Orlando's plans to announce a secondary offering in the near future.

C) Yes, because Zonding disclosed his firm's relationship with Orlando, his wife's ownership of the shares, and the availability of his Orlando report.

Question #6 of 60

Question ID: 691498

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The background check reveals the following:

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ii. As an intern at Lammar Corp., Cooken was fired after revealing to the FBI that one of the principals was embezzling from the firm's clients.
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To supplement the meager income from her entry-level stock-analysis job, Cooken looks for part-time work. She is offered a position working three hours each Friday and Saturday night tending bar at a sports bar and grill downtown. Cooken does not tell her employer about the job.

During her first week, Cooken has lunch with former MBA classmates, including Taira Basch, CFA, who works for the compliance officer at a large investment bank in town. Basch arrives late, explaining, "What a day, it's only noon and already I have worked on the following requests:

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....

Did Zonding follow the recommended procedures of the CFA Institute Research Objectivity Standards (ROS) with regard to Khasko's rating of Orlando Stores?

A) No.

B) Yes, because Zonding stated his rating recommendation and his time horizon on his rating.

C) Yes, because Zonding discussed his concerns about Orlando's expansion plans, so it was appropriate to recommend selling the shares to capitalize on near-term price increases.

Question #7 of 60

Question ID: 691499

Questions 67-72 relate to Andrea Vrbenic.

Andrea Vrbenic, CFA, was recently promoted to supervisory analyst at a boutique investment bank that specializes in managing initial public offerings for firms in the biotech industry. The firm also manages assets for high net worth clients. Vrbenic will report to Tom Sheffield, a senior manager and director in the investment banking department at the firm.

Wilhelmina Scott, CFA, who also reports to Sheffield, will be Vrbenic's supervisory analyst counterpart on the investment management side. Vrbenic will assume responsibility for all research prepared on subject companies that engage in investment banking business with the firm, while Scott will continue to supervise research covering a small group of companies that constitutes the firm's approved list.

Sheffield assigns Vrbenic the task of ensuring compliance with CFA Institute Research Objectivity Standards that cover herself, Scott, and other analysts at the firm. Sheffield recognizes that this policy is comprehensive and must apply not only to analysts on the investment banking side, but also to research analysts on the investment management side.

Vrbenic soon realizes that investment bankers at the firm use her research reports to help attract new investment banking clients. Vrbenic also learns that coverage of subject companies on the investment banking side will move over to the investment management side if these companies decline to continue an investment banking relationship. Sheffield tells Vrbenic that "the companies are golden while they have an investment banking relationship with us, but may lose their luster after they move to the investment management research side."

Vrbenic and Scott each receive a salary and two bonuses-one based on the investment banking division performance and one based on investment management division performance during a quarter. Sheffield attests annually that the firm has followed CFA Institute Research Objectivity Standards (ROS).

CFA Institute Research Objectivity Standards (ROS).

Sheffield attends a meeting with Vrbenic and her analysts. During the meeting, Jamie Verhallen, a research analyst reporting to Vrbenic, presents an overview of a biotech firm that will soon issue additional equity through their investment bank. While Verhallen recommends a favorable rating for the stock, Vrbenic recommends a higher rating due to the investment banking relationship with the firm. Verhallen refuses to sign the report with the changes that Vrbenic recommended during the meeting. Vrbenic transfers responsibility for research on the company to herself and issues the report with a higher rating.

Later that week, Verhallen tells Vrbenic of her father's impending kidney transplant. Verhallen's father has limited income, and Verhallen has agreed to assist with the medical expenses. Verhallen has decided to sell her holdings of the biotech company to raise cash for the operation.

Vrbenic appears on a financial news TV channel that same week describing the positive attributes of the biotech company. To protect her privacy, Vrbenic does not disclose her position in the securities. Vrbenic suggests that members of the audience must become clients prior to receiving any research from her firm.

....

Under the Research Objectivity Standards, Vrbenic's firm:

A) may permit Sheffield to supervise investment management research.

B) must segregate analysts reporting to Scott from the investment banking department.

C) must prevent research analysts from covering companies that have an investment banking relationship with the firm.

Question #8 of 60

Question ID: 691500

Andrea Vrbenic, CFA, was recently promoted to supervisory analyst at a boutique investment bank that specializes in managing initial public offerings for firms in the biotech industry. The firm also manages assets for high net worth clients. Vrbenic will report to Tom Sheffield, a senior manager and director in the investment banking department at the firm.

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....

According to the Research Objectivity Standards, Verhallen may sell her stock in the biotech company only if she:

A) disagrees with a recommendation.

B) has encountered a financial hardship.

C) has encountered a financial hardship and disagrees with the recommendation.

Question #9 of 60

Question ID: 691501

Andrea Vrbenic, CFA, was recently promoted to supervisory analyst at a boutique investment bank that specializes in managing initial public offerings for firms in the biotech industry. The firm also manages assets for high net worth clients. Vrbenic will report to Tom Sheffield, a senior manager and director in the investment banking department at the firm.

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....

Vrbenic's recommendation to raise the biotech company's rating solely based on investment banking relationship violates the Research Objectivity Standards:

A) only because the analyst reports to her.

B) because the standards require a reasonable basis for research recommendations.

C) because the standards require that firms refuse to provide research recommendations when there is any conflict of interest.

Question #10 of 60

Question ID: 691502

Andrea Vrbenic, CFA, was recently promoted to supervisory analyst at a boutique investment bank that specializes in managing initial public offerings for firms in the biotech industry. The firm also manages assets for high net worth clients. Vrbenic will report to Tom Sheffield, a senior manager and director in the investment banking department at the firm.

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Sheffield assigns Vrbenic the task of ensuring compliance with CFA Institute Research Objectivity Standards that cover herself, Scott, and other analysts at the firm. Sheffield recognizes that this policy is comprehensive and must apply not only to analysts on the investment banking side, but also to research analysts on the investment management side.

Vrbenic soon realizes that investment bankers at the firm use her research reports to help attract new investment banking clients. Vrbenic also learns that coverage of subject companies on the investment banking side will move over to the

investment management side if these companies decline to continue an investment banking relationship. Sheffield tells Vrbenic that "the companies are golden while they have an investment banking relationship with us, but may lose their luster after they move to the investment management research side."

Vrbenic and Scott each receive a salary and two bonuses-one based on the investment banking division performance and one based on investment management division performance during a quarter. Sheffield attests annually that the firm has followed CFA Institute Research Objectivity Standards (ROS).

Sheffield attends a meeting with Vrbenic and her analysts. During the meeting, Jamie Verhallen, a research analyst reporting to Vrbenic, presents an overview of a biotech firm that will soon issue additional equity through their investment bank. While Verhallen recommends a favorable rating for the stock, Vrbenic recommends a higher rating due to the investment banking relationship with the firm. Verhallen refuses to sign the report with the changes that Vrbenic recommended during the meeting. Vrbenic transfers responsibility for research on the company to herself and issues the report with a higher rating.

Later that week, Verhallen tells Vrbenic of her father's impending kidney transplant. Verhallen's father has limited income, and Verhallen has agreed to assist with the medical expenses. Verhallen has decided to sell her holdings of the biotech company to raise cash for the operation.

Vrbenic appears on a financial news TV channel that same week describing the positive attributes of the biotech company. To protect her privacy, Vrbenic does not disclose her position in the securities. Vrbenic suggests that members of the audience must become clients prior to receiving any research from her firm.

....

Under the Research Objectivity Standards, an acceptable compensation system for research analysts is *most likely* to:

A) have an incentive component.

B) align analyst compensation with the accuracy of research at the end of every quarter.

C) be based on measurable criteria for quality of research.

Question #11 of 60

Question ID: 691503

Andrea Vrbenic, CFA, was recently promoted to supervisory analyst at a boutique investment bank that specializes in managing initial public offerings for firms in the biotech industry. The firm also manages assets for high net worth clients. Vrbenic will report to Tom Sheffield, a senior manager and director in the investment banking department at the firm.

Wilhelmina Scott, CFA, who also reports to Sheffield, will be Vrbenic's supervisory analyst counterpart on the investment management side. Vrbenic will assume responsibility for all research prepared on subject companies that engage in investment banking business with the firm, while Scott will continue to supervise research covering a small group of companies that constitutes the firm's approved list.

Sheffield assigns Vrbenic the task of ensuring compliance with CFA Institute Research Objectivity Standards that cover herself, Scott, and other analysts at the firm. Sheffield recognizes that this policy is comprehensive and must apply not only to analysts on the investment banking side, but also to research analysts on the investment management side.

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Later that week, Verhallen tells Vrbenic of her father's impending kidney transplant. Verhallen's father has limited income, and Verhallen has agreed to assist with the medical expenses. Verhallen has decided to sell her holdings of the biotech company to raise cash for the operation.

Vrbenic appears on a financial news TV channel that same week describing the positive attributes of the biotech company. To protect her privacy, Vrbenic does not disclose her position in the securities. Vrbenic suggests that members of the audience must become clients prior to receiving any research from her firm.

....

Vrbenic has violated the Research Objectivity Standards through her public appearance by failing to:

A) disclose her position in the securities but not by failing to provide a copy of the research that she discussed.

B) provide a copy of the research that she discussed but not by failing to disclose her position in the securities.

C) disclose her position in the securities as well as by failing to provide a copy of the research that she discussed.

Question #12 of 60

Question ID: 691504

Andrea Vrbenic, CFA, was recently promoted to supervisory analyst at a boutique investment bank that specializes in managing initial public offerings for firms in the biotech industry. The firm also manages assets for high net worth clients. Vrbenic will report to Tom Sheffield, a senior manager and director in the investment banking department at the firm.

Wilhelmina Scott, CFA, who also reports to Sheffield, will be Vrbenic's supervisory analyst counterpart on the investment management side. Vrbenic will assume responsibility for all research prepared on subject companies that engage in investment banking business with the firm, while Scott will continue to supervise research covering a small group of companies that constitutes the firm's approved list.

Sheffield assigns Vrbenic the task of ensuring compliance with CFA Institute Research Objectivity Standards that cover herself, Scott, and other analysts at the firm. Sheffield recognizes that this policy is comprehensive and must apply not only to analysts on the investment banking side, but also to research analysts on the investment management side.

Vrbenic soon realizes that investment bankers at the firm use her research reports to help attract new investment banking clients. Vrbenic also learns that coverage of subject companies on the investment banking side will move over to the investment management side if these companies decline to continue an investment banking relationship. Sheffield tells Vrbenic that "the companies are golden while they have an investment banking relationship with us, but may lose their luster after they move to the investment management research side."

Vrbenic and Scott each receive a salary and two bonuses-one based on the investment banking division performance and one based on investment management division performance during a quarter. Sheffield attests annually that the firm has followed CFA Institute Research Objectivity Standards (ROS).

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Vrbenic appears on a financial news TV channel that same week describing the positive attributes of the biotech company. To protect her privacy, Vrbenic does not disclose her position in the securities. Vrbenic suggests that members of the audience must become clients prior to receiving any research from her firm.

....

To be consistent with the Research Objectivity Standards, Vrbenic's firm is required to issue research reports:

A) at least annually.
B) at least quarterly.
C) on a regular and timely basis.

Question #13 of 60

Question ID: 691511

Questions 73-78 relate to Robert Williams.

Robert Williams is a junior analyst at Anderson Brothers, a large Wall Street brokerage firm. He reports to Will McDonald, the chief economist for Anderson Brothers. McDonald provides economic research, forecasts, and interpretation of economic data to all of Anderson's investment departments, as well as to the firm's clients. McDonald has asked Williams to analyze economic trends in the country of Bundovia. Bundovia has strict capital controls limiting the flow of capital into and out of the country. The currency of Bundovia is the bunco (BUN).

One of Bundovia's major exports is high quality carpets. However, human rights activists have recently begun to complain about child labor practices among Bundovian carpet manufacturers, and this has resulted in negative publicity for the industry. Concerned about the impact on Bundovian exports, the Bundovian government banned child labor and provided oversight authority to the Bundovian carpet manufacturer's association. The Bundovian carpet manufacturer's association is an independent, membership-based organization. Most large carpet manufacturers in Bundovia are members.

McDonald believes that the Bundovian economy is experiencing a hyper-inflationary environment and that the Bundovian government is poised to follow a restrictive monetary and fiscal policy to combat high inflation.

In analyzing Bundovian economic performance, Williams notices that Bundovia has been able to grow rapidly in the past few years and has reached a steady state of growth. Compared to its trading partners, Bundovia has low capital-to-labor ratios; this situation is expected to continue.

Williams is also permitted to trade in the forex markets when he sees an opportunity to make a profit. Williams' bank quotes the following exchange rates to him:

- USD/GBP = 2.0010 - 20
- USD/SFr = 0.8550 - 60

Williams asks the bank for a GBP/SFr cross rate.

Williams receives the following forward rate quotes from the same bank:

- 30-day forward rate: USD/GBP = 2.0045 - 55
- 60-day forward rate: USD/GBP = 2.0075 - 85

Williams decides to go long 1 million GBP (and short USD) in the 60-day forward contract.

30 days after the initiation of the USD/GBP forward contract, the exchange rate and interest rates are as follows:

Quotes	USD/GBP
Spot	2.0086/2.0089
30-day forward	+7.6/+8
60-day forward	+8.7/+9.1
90-day forward	+9.2/+9.8

Interest Rates	USD	GBP
30 day	4.00%	3.00%
60 day	4.25%	3.00%
90 day	4.29%	3.00%

Williams spots another potential arbitrage opportunity in the foreign exchange markets. The current spot rate is $2.00 per BUN. The Bundovian risk-free interest rate is 3%, the one-year forward rate is $2.10 per BUN, and the U.S. risk-free rate is 5%.

....

To carry out the objectives of the Bundovian child labor regulations, the *most important* requirement is that the Bundovian carpet manufacturer's association should:

A) have the ability to effectively supervise the industry practices.

B) be properly supervised by the government.

C) be able to impose sanctions.

Question #14 of 60

Question ID: 691508

Robert Williams is a junior analyst at Anderson Brothers, a large Wall Street brokerage firm. He reports to Will McDonald, the chief economist for Anderson Brothers. McDonald provides economic research, forecasts, and interpretation of economic data to all of Anderson's investment departments, as well as to the firm's clients. McDonald has asked Williams to analyze economic trends in the country of Bundovia. Bundovia has strict capital controls limiting the flow of capital into and out of the country. The currency of Bundovia is the bunco (BUN).

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In analyzing Bundovian economic performance, Williams notices that Bundovia has been able to grow rapidly in the past few years and has reached a steady state of growth. Compared to its trading partners, Bundovia has low capital-to-labor ratios; this situation is expected to continue.

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Spot	2.0086/2.0089
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Interest Rates	USD	GBP
30 day	4.00%	3.00%
60 day	4.25%	3.00%
90 day	4.29%	3.00%

Williams spots another potential arbitrage opportunity in the foreign exchange markets. The current spot rate is $2.00 per BUN. The Bundovian risk-free interest rate is 3%, the one-year forward rate is $2.10 per BUN, and the U.S. risk-free rate is 5%.

....

Based on McDonald's beliefs about Bundovian government monetary and fiscal policies, under the Mundell-Fleming model the Bunco is *most likely* expected to:

A) depreciate.
B) appreciate.
C) remain unchanged in value.

Question #15 of 60

Question ID: 691509

Robert Williams is a junior analyst at Anderson Brothers, a large Wall Street brokerage firm. He reports to Will McDonald, the chief economist for Anderson Brothers. McDonald provides economic research, forecasts, and interpretation of economic data to all of Anderson's investment departments, as well as to the firm's clients. McDonald has asked Williams to analyze economic trends in the country of Bundovia. Bundovia has strict capital controls limiting the flow of capital into and out of the country. The currency of Bundovia is the bunco (BUN).

One of Bundovia's major exports is high quality carpets. However, human rights activists have recently begun to complain about child labor practices among Bundovian carpet manufacturers, and this has resulted in negative publicity for the industry. Concerned about the impact on Bundovian exports, the Bundovian government banned child labor and provided oversight authority to the Bundovian carpet manufacturer's association. The Bundovian carpet manufacturer's association is an independent, membership-based organization. Most large carpet manufacturers in Bundovia are members.

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Williams asks the bank for a GBP/SFr cross rate.

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Williams decides to go long 1 million GBP (and short USD) in the 60-day forward contract.

30 days after the initiation of the USD/GBP forward contract, the exchange rate and interest rates are as follows:

Quotes	USD/GBP	
Spot	2.0086/2.0089	
30-day forward	+7.6/+8	
60-day forward	+8.7/+9.1	
90-day forward	+9.2/+9.8	
Interest Rates	USD	GBP
30 day	4.00%	3.00%
60 day	4.25%	3.00%
90 day	4.29%	3.00%

Williams spots another potential arbitrage opportunity in the foreign exchange markets. The current spot rate is $2.00 per BUN. The Bundovian risk-free interest rate is 3%, the one-year forward rate is $2.10 per BUN, and the U.S. risk-free rate is 5%.

....

Under neoclassical growth theory, the Bundovian growth rate is *most likely* to increase due to:

A) capital deepening.

B) technological growth.

C) either capital deepening or technological growth.

Question #16 of 60

Question ID: 691505

Robert Williams is a junior analyst at Anderson Brothers, a large Wall Street brokerage firm. He reports to Will McDonald, the chief economist for Anderson Brothers. McDonald provides economic research, forecasts, and interpretation of economic data to all of Anderson's investment departments, as well as to the firm's clients. McDonald has asked Williams to analyze economic trends in the country of Bundovia. Bundovia has strict capital controls limiting the flow of capital into and out of the country. The currency of Bundovia is the bunco (BUN).

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McDonald believes that the Bundovian economy is experiencing a hyper-inflationary environment and that the Bundovian government is poised to follow a restrictive monetary and fiscal policy to combat high inflation.

In analyzing Bundovian economic performance, Williams notices that Bundovia has been able to grow rapidly in the past few years and has reached a steady state of growth. Compared to its trading partners, Bundovia has low capital-to-labor ratios; this situation is expected to continue.

Williams is also permitted to trade in the forex markets when he sees an opportunity to make a profit. Williams' bank quotes the following exchange rates to him:

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Williams asks the bank for a GBP/SFr cross rate.

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30 days after the initiation of the USD/GBP forward contract, the exchange rate and interest rates are as follows:

Quotes	USD/GBP	
Spot	2.0086/2.0089	
30-day forward	+7.6/+8	
60-day forward	+8.7/+9.1	
90-day forward	+9.2/+9.8	
Interest Rates	USD	GBP
30 day	4.00%	3.00%
60 day	4.25%	3.00%
90 day	4.29%	3.00%

Williams spots another potential arbitrage opportunity in the foreign exchange markets. The current spot rate is $2.00 per BUN. The Bundovian risk-free interest rate is 3%, the one-year forward rate is $2.10 per BUN, and the U.S. risk-free rate is 5%.

Based on the bank's USD/GBP and USD/SFr quotes, Williams's bank is *most likely* to quote a cross rate of:

A) GBP/SFr = 0.4271 - 78.

B) GBP/SFr = 2.3375 - 14.

C) GBP/SFr = 0.4273 - 76.

Question #17 of 60

Question ID: 691506

Robert Williams is a junior analyst at Anderson Brothers, a large Wall Street brokerage firm. He reports to Will McDonald, the chief economist for Anderson Brothers. McDonald provides economic research, forecasts, and interpretation of economic data to all of Anderson's investment departments, as well as to the firm's clients. McDonald has asked Williams to analyze economic trends in the country of Bundovia. Bundovia has strict capital controls limiting the flow of capital into and out of the country. The currency of Bundovia is the bunco (BUN).

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Williams decides to go long 1 million GBP (and short USD) in the 60-day forward contract.

30 days after the initiation of the USD/GBP forward contract, the exchange rate and interest rates are as follows:

Quotes	USD/GBP
Spot	2.0086/2.0089
30-day forward	+7.6/+8
60-day forward	+8.7/+9.1
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Interest Rates	USD	GBP
30 day	4.00%	3.00%
60 day	4.25%	3.00%
90 day	4.29%	3.00%

Williams spots another potential arbitrage opportunity in the foreign exchange markets. The current spot rate is $2.00 per BUN. The Bundovian risk-free interest rate is 3%, the one-year forward rate is $2.10 per BUN, and the U.S. risk-free rate is 5%.

....

30 days after initiation of the USD/GBP forward contract, the mark-to-market value of the contract is *closest* to:

A) USD 860.

B) USD 1,195.

C) USD 2,190.

Question #18 of 60

Question ID: 691507

Robert Williams is a junior analyst at Anderson Brothers, a large Wall Street brokerage firm. He reports to Will McDonald, the chief economist for Anderson Brothers. McDonald provides economic research, forecasts, and interpretation of economic data to all of Anderson's investment departments, as well as to the firm's clients. McDonald has asked Williams to analyze economic trends in the country of Bundovia. Bundovia has strict capital controls limiting the flow of capital into and out of the country. The currency of Bundovia is the bunco (BUN).

One of Bundovia's major exports is high quality carpets. However, human rights activists have recently begun to complain about child labor practices among Bundovian carpet manufacturers, and this has resulted in negative publicity for the industry. Concerned about the impact on Bundovian exports, the Bundovian government banned child labor and provided oversight authority to the Bundovian carpet manufacturer's association. The Bundovian carpet manufacturer's association is an independent, membership-based organization. Most large carpet manufacturers in Bundovia are members.

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In analyzing Bundovian economic performance, Williams notices that Bundovia has been able to grow rapidly in the past few years and has reached a steady state of growth. Compared to its trading partners, Bundovia has low capital-to-labor ratios; this situation is expected to continue.

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Williams asks the bank for a GBP/SFr cross rate.

Williams receives the following forward rate quotes from the same bank:

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Williams decides to go long 1 million GBP (and short USD) in the 60-day forward contract.

30 days after the initiation of the USD/GBP forward contract, the exchange rate and interest rates are as follows:

Quotes	USD/GBP	
Spot	2.0086/2.0089	
30-day forward	+7.6/+8	
60-day forward	+8.7/+9.1	
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Interest Rates	USD	GBP
30 day	4.00%	3.00%
60 day	4.25%	3.00%
90 day	4.29%	3.00%

Williams spots another potential arbitrage opportunity in the foreign exchange markets. The current spot rate is $2.00 per BUN. The Bundovian risk-free interest rate is 3%, the one-year forward rate is $2.10 per BUN, and the U.S. risk-free rate is 5%.

....

The maximum profit available from covered interest arbitrage in the USD/BUN market by borrowing $1,000 or the BUN equivalent is *closest* to:

A) $19.05.
B) $31.50.
C) $72.50.

Question #19 of 60

Question ID: 691530

Questions 79-84 relate to High Plains Tubular.

High Plains Tubular Company is a leading manufacturer and distributor of quality steel products used in energy, industrial, and automotive applications worldwide.

The U.S. steel industry has been challenged in recent years by competition from foreign producers located primarily in Asia. U.S. producers are experiencing declining margins as labor costs continue to increase. In addition, most U.S. steel mills are technologically inferior to those of foreign competitors and U.S. producers have significant unresolved issues related to complying with environmental protection laws.

High Plains is not immune from the problems of the industry and is currently in technical default under its bond covenants. The default is a result of the firm's failure to meet certain coverage and turnover ratios. High Plains has argued that this is largely due to the favorable credit terms it has given to its customers (major customers are given 90 days to settle) in order to gain market share.

Earlier this year, High Plains and its bondholders entered into an agreement that will give High Plains time to come into compliance with the covenants. If High Plains is not in compliance by year-end, the bondholders can immediately accelerate

the maturity date of the bonds. In that case, High Plains would have no choice but to file for bankruptcy.

High Plains follows U.S. GAAP. For the year ended 2014, High Plains received an unqualified opinion from its independent auditor. However, the auditor's opinion included an explanatory paragraph about High Plains' inability to continue as a going concern in the event its bonds remain in technical default.

At the end of 2014, High Plains' Chief Executive Officer (CEO) and Chief Financial Officer (CFO) filed the certifications required by the Securities and Exchange Commission (SEC).

Jon Farnsworth, CFA, is reviewing High Plains' financial accounts to gain a better understanding of credit risk of the company. The first element that causes Farnsworth some concern is the cash flow statement. This is shown in Exhibit 1.

Exhibit 1: Cash Flow Statement

High Plains Tubular Cash Flow Statement		
	Year ended December 31,	
in thousands	**2014**	**2013**
Net income	$158,177	$121,164
Depreciation expense	34,078	31,295
Deferred taxes	7,697	11,407
Receivables	(144,087)	(24,852)
Inventory	(79,710)	(72,777)
Payables	36,107	22,455
Cash flow from operations (CFO)	$12,262	$88,692
Cash flow from investing (CFI)	($39,884)	($63,953)
Cash flow from financing	$82,676	$6,056
Change in cash	$55,054	$30,795

Exhibit 2: Selected Financial Footnotes

1. During 2014, High Plains' sales increased 27% over 2013. Its sales growth continues to significantly exceed the industry average. Sales are recognized when a firm order is received from the customer, the sales price is fixed and determinable, and collectability is reasonably assured. In limited cases, some product is sold on a bill-and-hold basis provided that the goods are completed, packaged and ready for shipment; such goods are segregated and the risks of ownership and legal title have passed to the customer. Total revenue from such sales amounted to $907.95 million in 2014. (2013: zero.)
2. The cost of inventories is determined using the last-in, first-out (LIFO) method. Had the first-in, first-out (FIFO) method been used, inventories would have been $152 million and $143 million higher as of December 31, 2014 and 2013, respectively.
3. Effective January 1, 2014, High Plains changed its depreciation method from the double-declining balance method to the straight-line method in order to be more comparable with the accounting practices of other firms within its industry. The change was not retroactively applied and only affects assets that were acquired on or after January 1, 2014.
4. High Plains made the following discretionary expenditures for maintenance and repair of plant and equipment, and for advertising and marketing:

in millions	**2014**	**2013**	**2012**
Maintenance and repairs	$180	$184	$218

Maintenance and repairs	$180	$184	$218
Advertising and marketing	$94	$108	$150

5. During the fiscal year ended December 31, 2014, High Plains sold $50 million of its accounts receivable to a third party.
6. High Plains conducts some of its operations in facilities leased under noncancelable finance (capital) leases. Certain leases include renewal options with provisions for increased lease payments during the renewal term.
7. High Plains reclassified $2.9 million of inventory as other assets in 2014. This material had been reported within inventory as work-in-progress in 2013.

After reviewing the cash flow statement and footnotes, Farnsworth analyzes the impact of the bill and hold sales outlined in Exhibit 1 using the assumptions shown in Exhibit 3.

Exhibit 3: Bill-and-Hold Analysis

High Plains EBT margin	5.1%
Average tax rate	28%

....

Which of the following statements regarding High Plains' cash flow quality is *least* accurate?

A) The transaction described in footnote 5 of Exhibit 2 would have increased cash flow from operations (CFO) in 2014 but decreased the quality of cash flow in 2014.

B) The decrease in accounts payable in 2013 increased the quality of cash flow as High Plains is paying off suppliers more rapidly.

C) The divergence between net income and cash flow from operations (CFO) may be an indication of earnings manipulation.

Question #20 of 60

Question ID: 691528

High Plains Tubular Company is a leading manufacturer and distributor of quality steel products used in energy, industrial, and automotive applications worldwide.

The U.S. steel industry has been challenged in recent years by competition from foreign producers located primarily in Asia. U.S. producers are experiencing declining margins as labor costs continue to increase. In addition, most U.S. steel mills are technologically inferior to those of foreign competitors and U.S. producers have significant unresolved issues related to complying with environmental protection laws.

High Plains is not immune from the problems of the industry and is currently in technical default under its bond covenants. The default is a result of the firm's failure to meet certain coverage and turnover ratios. High Plains has argued that this is largely due to the favorable credit terms it has given to its customers (major customers are given 90 days to settle) in order to gain market share.

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Exhibit 1: Cash Flow Statement

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	Year ended December 31,	
in thousands	**2014**	**2013**
Net income	$158,177	$121,164
Depreciation expense	34,078	31,295
Deferred taxes	7,697	11,407
Receivables	(144,087)	(24,852)
Inventory	(79,710)	(72,777)
Payables	36,107	22,455
Cash flow from operations (CFO)	$12,262	$88,692
Cash flow from investing (CFI)	($39,884)	($63,953)
Cash flow from financing	$82,676	$6,056
Change in cash	$55,054	$30,795

Exhibit 2: Selected Financial Footnotes

1. During 2014, High Plains' sales increased 27% over 2013. Its sales growth continues to significantly exceed the industry average. Sales are recognized when a firm order is received from the customer, the sales price is fixed and determinable, and collectability is reasonably assured. In limited cases, some product is sold on a bill-and-hold basis provided that the goods are completed, packaged and ready for shipment; such goods are segregated and the risks of ownership and legal title have passed to the customer. Total revenue from such sales amounted to $907.95 million in 2014. (2013: zero.)
2. The cost of inventories is determined using the last-in, first-out (LIFO) method. Had the first-in, first-out (FIFO) method been used, inventories would have been $152 million and $143 million higher as of December 31, 2014 and 2013, respectively.
3. Effective January 1, 2014, High Plains changed its depreciation method from the double-declining balance method to the straight-line method in order to be more comparable with the accounting practices of other firms within its industry. The change was not retroactively applied and only affects assets that were acquired on or after January 1, 2014.
4. High Plains made the following discretionary expenditures for maintenance and repair of plant and equipment, and for advertising and marketing:

in millions	**2014**	**2013**	**2012**
Maintenance and repairs	$180	$184	$218

Advertising and marketing	$94	$108	$150

5. During the fiscal year ended December 31, 2014, High Plains sold $50 million of its accounts receivable to a third party.
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After reviewing the cash flow statement and footnotes, Farnsworth analyzes the impact of the bill and hold sales outlined in Exhibit 1 using the assumptions shown in Exhibit 3.

Exhibit 3: Bill-and-Hold Analysis

High Plains EBT margin	5.1%
Average tax rate	28%

What is the *most likely* effect of High Plains' revenue recognition policy on net income and inventory turnover?

A) Both net income and inventory turnover are overstated.

B) Only net income is overstated.

C) Only inventory turnover is overstated.

Question #21 of 60

Question ID: 691529

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Exhibit 3: Bill-and-Hold Analysis

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Average tax rate	28%

....

Applying the assumptions in Exhibit 3 to the relevant disclosures given in Exhibits 1 and 2, Farnsworth is *most likely* to conclude that bill-and-hold sales contributed:

A) more than 20% of net income in 2014.

B) approximately 10% of net income in 2014.

C) less than 10% of net income in 2014.

Question #22 of 60

Question ID: 691526

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Exhibit 3: Bill-and-Hold Analysis

High Plains EBT margin	5.1%
Average tax rate	28%

Using only the information found in Exhibit 1 and Exhibit 2, which of the following is *most* indicative of lower earnings quality?

A) High Plains' discretionary expenses.

B) The change in High Plains' depreciation method.

C) High Plains' inventory cost flow assumption.

Question #23 of 60

Question ID: 691525

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Exhibit 3: Bill-and-Hold Analysis

High Plains EBT margin	5.1%
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....

Which of the accounting treatments described in footnotes 6 and 7 of Exhibit 2 is *likely* to lower High Plains' financial reporting quality?

A) Both treatments lower financial reporting quality.

B) Only the treatment in footnote 6 lowers financial reporting quality.

C) Only the treatment in footnote 7 lowers financial reporting quality.

Question #24 of 60

Question ID: 691527

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Exhibit 3: Bill-and-Hold Analysis

High Plains EBT margin	5.1%
Average tax rate	28%

Which of the following statements about High Plains' financial reporting quality is *least* accurate?

A) High Plains may have manipulated earnings due to the risk of default.

B) High Plains' extreme revenue growth will likely revert back to normal levels over time.

C) Due to High Plains' lengthy credit terms for customers, analysts should place a higher weighting on the accruals-based element of earnings rather than the cash-based element.

Question #25 of 60

Question ID: 692336

Questions 85-90 relate to Stanley Bostwick.

Stanley Bostwick, CFA, is a business services industry analyst with Mortonworld Financial. Currently, his attention is focused on the 20X8 financial statements of Global Oilfield Supply, particularly the footnote disclosures related to the company's employee benefit plans. Bostwick would like to analyze the effect on the reported results of changes in assumptions the company used to estimate the projected benefit obligation (PBO) and net pension cost. But first, Bostwick must familiarize himself with the differences in the accounting for defined contribution and defined benefit pension plans.

Global Oilfield's financial statements are prepared in accordance with International Financial Reporting Standards (IFRS). Excerpts from the company's annual report are shown in the following exhibits.

Exhibit 1: Reconciliation of Projected Benefit Obligation

(in thousands)	**20X8**	**20X7**	**20X6**
Change in projected benefit obligation:			
Benefit obligation at beginning of year	€64,230	€50,534	€39,132
Service cost	8,091	8,038	6,607
Interest cost	4,335	3,158	2,641
Actuarial loss (gain)	(1,932)	5,034	4,590
Benefits paid	(3,824)	(2,534)	(2,436)
Projected benefit obligation at end of year	€70,900	€64,230	€50,534

Exhibit 2: Reconciliation of Fair Value of Plan Assets

(in thousands)	**20X8**	**20X7**	**20X6**
Change in plan assets:			
Fair value of plan assets at beginning of year	€65,164	€44,296	€35,796
Actual return on plan assets	7,084	9,916	(1,868)
Employer contributions	5,000	13,486	12,804
Benefits paid	(3,824)	(2,534)	(2,436)
Fair value of plan assets at end of year	€73,424	€65,164	€44,296

Exhibit 3: Reported Pension Expense

(in thousands)	**20X8**	**20X7**	**20X6**
Service cost	€8,091	€8,038	€6,607
Net interest cost (income)	(63)	390	225
Pension expense	€8,028	€8,428	€6,832

Exhibit 4: Weighted Average Pension Assumptions

	20X8	**20X7**	**20X6**
Discount rate	6.75%	6.25%	6.75%
Rate of compensation growth	5.00%	5.00%	5.00%

If Global Oilfield's retirement plan is a defined contribution arrangement, which of the following statements would be the *most* correct?

A) Pension expense and the cash funding amount would be the same.

B) The potential gains or losses from the assets contributed to the plan are borne by the firm.

C) The firm would report the difference in the benefit obligation and the plan assets on the balance sheet.

Question #26 of 60

Question ID: 692337

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Discount rate	6.75%	6.25%	6.75%
Rate of compensation growth	5.00%	5.00%	5.00%

If Global Oilfield were to adopt U.S. pension accounting standards, what adjustment, if any, is necessary to its balance sheet at the end of 20X8 assuming no taxes?

A) Decrease assets by €7,222, decrease liabilities €2,524, and decrease equity by €4,698.

B) Decrease assets by €4,698 and decrease equity by €4,698.

C) No adjustment is necessary.

Question #27 of 60

Question ID: 692338

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Employer contributions	5,000	13,486	12,804
Benefits paid	(3,824)	(2,534)	(2,436)
Fair value of plan assets at end of year	€73,424	€65,164	€44,296

Exhibit 3: Reported Pension Expense

(in thousands)	**20X8**	**20X7**	**20X6**
Service cost	€8,091	€8,038	€6,607
Net interest cost (income)	(63)	390	225
Pension expense	€8,028	€8,428	€6,832

Exhibit 4: Weighted Average Pension Assumptions

	20X8	**20X7**	**20X6**
Discount rate	6.75%	6.25%	6.75%
Rate of compensation growth	5.00%	5.00%	5.00%

What was the *most likely* cause of the actuarial gain reported in the reconciliation of the projected benefit obligation for the year ended 20X8?

A) Increase in the average life expectancy of the participating employees.

B) Decrease in the expected rate of return.

C) Increase in the discount rate.

Question #28 of 60

Question ID: 692339

Stanley Bostwick, CFA, is a business services industry analyst with Mortonworld Financial. Currently, his attention is focused on the 20X8 financial statements of Global Oilfield Supply, particularly the footnote disclosures related to the company's employee benefit plans. Bostwick would like to analyze the effect on the reported results of changes in assumptions the company used to estimate the projected benefit obligation (PBO) and net pension cost. But first, Bostwick must familiarize himself with the differences in the accounting for defined contribution and defined benefit pension plans.

Global Oilfield's financial statements are prepared in accordance with International Financial Reporting Standards (IFRS). Excerpts from the company's annual report are shown in the following exhibits.

Exhibit 1: Reconciliation of Projected Benefit Obligation

(in thousands)	**20X8**	**20X7**	**20X6**
Change in projected benefit obligation:			
Benefit obligation at beginning of year	€64,230	€50,534	€39,132
Service cost	8,091	8,038	6,607
Interest cost	4,335	3,158	2,641
Actuarial loss (gain)	(1,932)	5,034	4,590
Benefits paid	(3,824)	(2,534)	(2,436)
Projected benefit obligation at end of year	€70,900	€64,230	€50,534

Exhibit 2: Reconciliation of Fair Value of Plan Assets

(in thousands)	**20X8**	**20X7**	**20X6**
Change in plan assets:			
Fair value of plan assets at beginning of year	€65,164	€44,296	€35,796
Actual return on plan assets	7,084	9,916	(1,868)
Employer contributions	5,000	13,486	12,804
Benefits paid	(3,824)	(2,534)	(2,436)
Fair value of plan assets at end of year	€73,424	€65,164	€44,296

Exhibit 3: Reported Pension Expense

(in thousands)	**20X8**	**20X7**	**20X6**
Service cost	€8,091	€8,038	€6,607
Net interest cost (income)	(63)	390	225
Pension expense	€8,028	€8,428	€6,832

Exhibit 4: Weighted Average Pension Assumptions

	20X8	**20X7**	**20X6**
Discount rate	6.75%	6.25%	6.75%

Rate of compensation growth	5.00%	5.00%	5.00%

Which of the following *best* describes the effects of a decrease in the rate of compensation growth during 20X9 all else equal? Global Oilfield's:

A) service cost is lower and the projected benefit obligation is higher.

B) pension expense is lower and the plan assets are higher.

C) net income is higher and the funded status is higher.

Question #29 of 60

Question ID: 692341

Stanley Bostwick, CFA, is a business services industry analyst with Mortonworld Financial. Currently, his attention is focused on the 20X8 financial statements of Global Oilfield Supply, particularly the footnote disclosures related to the company's employee benefit plans. Bostwick would like to analyze the effect on the reported results of changes in assumptions the company used to estimate the projected benefit obligation (PBO) and net pension cost. But first, Bostwick must familiarize himself with the differences in the accounting for defined contribution and defined benefit pension plans.

Global Oilfield's financial statements are prepared in accordance with International Financial Reporting Standards (IFRS). Excerpts from the company's annual report are shown in the following exhibits.

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(in thousands)	**20X8**	**20X7**	**20X6**
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Service cost	8,091	8,038	6,607
Interest cost	4,335	3,158	2,641
Actuarial loss (gain)	(1,932)	5,034	4,590
Benefits paid	(3,824)	(2,534)	(2,436)
Projected benefit obligation at end of year	€70,900	€64,230	€50,534

Exhibit 2: Reconciliation of Fair Value of Plan Assets

(in thousands)	**20X8**	**20X7**	**20X6**
Change in plan assets:			
Fair value of plan assets at beginning of year	€65,164	€44,296	€35,796
Actual return on plan assets	7,084	9,916	(1,868)
Employer contributions	5,000	13,486	12,804
Benefits paid	(3,824)	(2,534)	(2,436)
Fair value of plan assets at end of year	€73,424	€65,164	€44,296

Exhibit 3: Reported Pension Expense

Exhibit 3: Reported Pension Expense

(in thousands)	**20X8**	**20X7**	**20X6**
Service cost	€8,091	€8,038	€6,607
Net interest cost (income)	(63)	390	225
Pension expense	€8,028	€8,428	€6,832

Exhibit 4: Weighted Average Pension Assumptions

	20X8	**20X7**	**20X6**
Discount rate	6.75%	6.25%	6.75%
Rate of compensation growth	5.00%	5.00%	5.00%

As compared to Global Oilfield's reported pension expense, total periodic pension cost expense for the year ended 20X8 is:

A) higher.

B) lower.

C) the same.

Question #30 of 60

Question ID: 692340

Stanley Bostwick, CFA, is a business services industry analyst with Mortonworld Financial. Currently, his attention is focused on the 20X8 financial statements of Global Oilfield Supply, particularly the footnote disclosures related to the company's employee benefit plans. Bostwick would like to analyze the effect on the reported results of changes in assumptions the company used to estimate the projected benefit obligation (PBO) and net pension cost. But first, Bostwick must familiarize himself with the differences in the accounting for defined contribution and defined benefit pension plans.

Global Oilfield's financial statements are prepared in accordance with International Financial Reporting Standards (IFRS). Excerpts from the company's annual report are shown in the following exhibits.

Exhibit 1: Reconciliation of Projected Benefit Obligation

(in thousands)	**20X8**	**20X7**	**20X6**
Change in projected benefit obligation:			
Benefit obligation at beginning of year	€64,230	€50,534	€39,132
Service cost	8,091	8,038	6,607
Interest cost	4,335	3,158	2,641
Actuarial loss (gain)	(1,932)	5,034	4,590
Benefits paid	(3,824)	(2,534)	(2,436)
Projected benefit obligation at end of year	€70,900	€64,230	€50,534

Exhibit 2: Reconciliation of Fair Value of Plan Assets

(in thousands)	**20X8**	**20X7**	**20X6**
Change in plan assets:			
Fair value of plan assets at beginning of year	€65,164	€44,296	€35,796
Actual return on plan assets	7,084	9,916	(1,868)
Employer contributions	5,000	13,486	12,804
Benefits paid	(3,824)	(2,534)	(2,436)
Fair value of plan assets at end of year	€73,424	€65,164	€44,296

Exhibit 3: Reported Pension Expense

(in thousands)	**20X8**	**20X7**	**20X6**
Service cost	€8,091	€8,038	€6,607
Net interest cost (income)	(63)	390	225
Pension expense	€8,028	€8,428	€6,832

Exhibit 4: Weighted Average Pension Assumptions

	20X8	**20X7**	**20X6**
Discount rate	6.75%	6.25%	6.75%
Rate of compensation growth	5.00%	5.00%	5.00%

Assume for this question only that Global reports under U.S. GAAP and that the total periodic pension cost for the year ended 20X8 was 4,250. Ignoring income taxes, which of the following statements *best* describes the adjustment necessary for analyzing Global Oilfield's cash flow statement?

A) Increase operating cash flow €750 and decrease financing cash flow €750.
B) Decrease operating cash flow €2,084 and increase investing cash flow €2,084.
C) Increase operating cash flow €5,000 and decrease financing cash flow €5,000.

Question #31 of 60

Question ID: 692333

Questions 91-96 relate to Valley Airlines.

Jason Bennett is an analyst for Valley Airlines (Valley), a U.S. firm. Valley owns a stake in Southwest Air Cargo (Southwest), also a U.S. firm. The two firms have had a long-standing relationship. The relationship has become even closer because several of Valley's top executives hold seats on Southwest's Board of Directors.

Valley acquired a 45% ownership stake in Southwest on December 31, 2007. Acquisition of the ownership stake cost $9 million and was paid in cash. Valley's stake in Southwest is such that management can account for the investment using either the equity method or the acquisition method. While Valley's management desires to fairly represent the firm's operating results, they have assigned Bennett to assess the impact of each method on reported financial statements.

Immediately prior to the acquisition, Valley's current asset balance and total equity were $96 million and $80 million, respectively. Southwest's current assets and total equity were $32 million and $16 million, respectively.

While analyzing the use of the equity method versus the acquisition method, Bennett calculates the return on assets (ROA) ratio. He arrives at two conclusions:

Conclusion 1:	Compared to the acquisition method, the equity method results in a higher ROA because of the higher net income under the equity method.
Conclusion 2:	Compared to the acquisition method, the equity method results in a higher ROA because of the smaller level of total assets under the equity method.

He also makes the following statements regarding the acquisition method and equity method:

Statement 1:	The applicability of both methods is identical under U.S. GAAP and IFRS.
Statement 2:	Both methods report the same net income on the parent's consolidated income statement.
Statement 3:	Both methods report the same equity on the parent's consolidated balance sheet.

In addition, Valley has always wanted to pursue its goal of vertical integration by expanding its scope of operations to include the manufacturing of airline parts for its own airplanes. Therefore, it established a subsidiary, Mountain Air Parts (Mountain), in Switzerland on January 1, 2008. Switzerland was chosen as the location for economic and geographical diversification reasons. Mountain will operate as a self-contained, independent subsidiary. Local management in Switzerland will make the majority of operating, financing, and investing decisions.

The Swiss franc (CHF) is the official currency in Switzerland. On January 1, 2008, the USD/CHF exchange rate was 0.77. At December 31, 2008, the exchange rate had changed to 0.85 USD/CHF. The average exchange rate in 2008 was 0.80 USD/CHF. In its first year of operations, Mountain paid no dividends and no taxes. Mountain uses the FIFO assumption for its flow of inventory.

Moutain Air Parts

Balance Sheet

(in CHF thousands)	12/31/2008	1/1/2008
Assets		
Cash and accounts receivable	**600**	400
Inventory	**500**	500
Property, plant, and equipment	**600**	700
Total assets	**1,700**	**1,600**
Liabilities and equity		
Accounts payable	**200**	100
Long-term debt	**100**	200
Common stock	**1,300**	1,300

Retained earnings	**100**	0
Total liabilities and owner's equity	**1,700**	**1,600**

Mountain Air Parts

Income Statement for 2008

(in CHF thousands)

Sales	**7,000**
COGS	**(6,800)**
Depreciation	**(100)**
Net income	**100**

The balance of Valley's current assets as of December 31, 2007, using the acquisition method, is *closest* to:

A) $87 million.

B) $119 million.

C) $128 million.

Question #32 of 60

Question ID: 692334

Jason Bennett is an analyst for Valley Airlines (Valley), a U.S. firm. Valley owns a stake in Southwest Air Cargo (Southwest), also a U.S. firm. The two firms have had a long-standing relationship. The relationship has become even closer because several of Valley's top executives hold seats on Southwest's Board of Directors.

Valley acquired a 45% ownership stake in Southwest on December 31, 2007. Acquisition of the ownership stake cost $9 million and was paid in cash. Valley's stake in Southwest is such that management can account for the investment using either the equity method or the acquisition method. While Valley's management desires to fairly represent the firm's operating results, they have assigned Bennett to assess the impact of each method on reported financial statements.

Immediately prior to the acquisition, Valley's current asset balance and total equity were $96 million and $80 million, respectively. Southwest's current assets and total equity were $32 million and $16 million, respectively.

While analyzing the use of the equity method versus the acquisition method, Bennett calculates the return on assets (ROA) ratio. He arrives at two conclusions:

Conclusion 1:	Compared to the acquisition method, the equity method results in a higher ROA because of the higher net income under the equity method.
Conclusion 2:	Compared to the acquisition method, the equity method results in a higher ROA because of the smaller level of total assets under the equity method.

He also makes the following statements regarding the acquisition method and equity method:

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Statement 1:	The applicability of both methods is identical under U.S. GAAP and IFRS.
Statement 2:	Both methods report the same net income on the parent's consolidated income statement.
Statement 3:	Both methods report the same equity on the parent's consolidated balance sheet.

In addition, Valley has always wanted to pursue its goal of vertical integration by expanding its scope of operations to include the manufacturing of airline parts for its own airplanes. Therefore, it established a subsidiary, Mountain Air Parts (Mountain), in Switzerland on January 1, 2008. Switzerland was chosen as the location for economic and geographical diversification reasons. Mountain will operate as a self-contained, independent subsidiary. Local management in Switzerland will make the majority of operating, financing, and investing decisions.

The Swiss franc (CHF) is the official currency in Switzerland. On January 1, 2008, the USD/CHF exchange rate was 0.77. At December 31, 2008, the exchange rate had changed to 0.85 USD/CHF. The average exchange rate in 2008 was 0.80 USD/CHF. In its first year of operations, Mountain paid no dividends and no taxes. Mountain uses the FIFO assumption for its flow of inventory.

Moutain Air Parts

Balance Sheet

(in CHF thousands)	12/31/2008	1/1/2008
Assets		
Cash and accounts receivable	**600**	400
Inventory	**500**	500
Property, plant, and equipment	**600**	700
Total assets	**1,700**	**1,600**
Liabilities and equity		
Accounts payable	**200**	100
Long-term debt	**100**	200
Common stock	**1,300**	1,300
Retained earnings	**100**	0
Total liabilities and owner's equity	**1,700**	**1,600**

Mountain Air Parts

Income Statement for 2008

(in CHF thousands)	
Sales	**7,000**
COGS	**(6,800)**
Depreciation	**(100)**
Net income	**100**

Are Bennett's Conclusions 1 and 2 regarding ROA correct?

	Conclusion 1	Conclusion 2
A)	Yes	Yes
B)	Yes	No
C)	No	Yes

Question #33 of 60

Question ID: 692335

Jason Bennett is an analyst for Valley Airlines (Valley), a U.S. firm. Valley owns a stake in Southwest Air Cargo (Southwest), also a U.S. firm. The two firms have had a long-standing relationship. The relationship has become even closer because several of Valley's top executives hold seats on Southwest's Board of Directors.

Valley acquired a 45% ownership stake in Southwest on December 31, 2007. Acquisition of the ownership stake cost $9 million and was paid in cash. Valley's stake in Southwest is such that management can account for the investment using either the equity method or the acquisition method. While Valley's management desires to fairly represent the firm's operating results, they have assigned Bennett to assess the impact of each method on reported financial statements.

Immediately prior to the acquisition, Valley's current asset balance and total equity were $96 million and $80 million, respectively. Southwest's current assets and total equity were $32 million and $16 million, respectively.

While analyzing the use of the equity method versus the acquisition method, Bennett calculates the return on assets (ROA) ratio. He arrives at two conclusions:

Conclusion 1:	Compared to the acquisition method, the equity method results in a higher ROA because of the higher net income under the equity method.
Conclusion 2:	Compared to the acquisition method, the equity method results in a higher ROA because of the smaller level of total assets under the equity method.

He also makes the following statements regarding the acquisition method and equity method:

Statement 1:	The applicability of both methods is identical under U.S. GAAP and IFRS.
Statement 2:	Both methods report the same net income on the parent's consolidated income statement.
Statement 3:	Both methods report the same equity on the parent's consolidated balance sheet.

In addition, Valley has always wanted to pursue its goal of vertical integration by expanding its scope of operations to include the manufacturing of airline parts for its own airplanes. Therefore, it established a subsidiary, Mountain Air Parts (Mountain), in

Switzerland on January 1, 2008. Switzerland was chosen as the location for economic and geographical diversification reasons. Mountain will operate as a self-contained, independent subsidiary. Local management in Switzerland will make the majority of operating, financing, and investing decisions.

The Swiss franc (CHF) is the official currency in Switzerland. On January 1, 2008, the USD/CHF exchange rate was 0.77. At December 31, 2008, the exchange rate had changed to 0.85 USD/CHF. The average exchange rate in 2008 was 0.80 USD/CHF. In its first year of operations, Mountain paid no dividends and no taxes. Mountain uses the FIFO assumption for its flow of inventory.

Moutain Air Parts

Balance Sheet

(in CHF thousands)	12/31/2008	1/1/2008
Assets		
Cash and accounts receivable	**600**	400
Inventory	**500**	500
Property, plant, and equipment	**600**	700
Total assets	**1,700**	**1,600**
Liabilities and equity		
Accounts payable	**200**	100
Long-term debt	**100**	200
Common stock	**1,300**	1,300
Retained earnings	**100**	0
Total liabilities and owner's equity	**1,700**	**1,600**

Mountain Air Parts

Income Statement for 2008

(in CHF thousands)	
Sales	**7,000**
COGS	**(6,800)**
Depreciation	**(100)**
Net income	**100**

How many of statements 1-3 made by Bennet are correct?

A) None.

B) One.

C) Two.

Question #34 of 60

Question ID: 692342

Jason Bennett is an analyst for Valley Airlines (Valley), a U.S. firm. Valley owns a stake in Southwest Air Cargo (Southwest), also a U.S. firm. The two firms have had a long-standing relationship. The relationship has become even closer because several of Valley's top executives hold seats on Southwest's Board of Directors.

Valley acquired a 45% ownership stake in Southwest on December 31, 2007. Acquisition of the ownership stake cost $9 million and was paid in cash. Valley's stake in Southwest is such that management can account for the investment using either the equity method or the acquisition method. While Valley's management desires to fairly represent the firm's operating results, they have assigned Bennett to assess the impact of each method on reported financial statements.

Immediately prior to the acquisition, Valley's current asset balance and total equity were $96 million and $80 million, respectively. Southwest's current assets and total equity were $32 million and $16 million, respectively.

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Conclusion 1:	Compared to the acquisition method, the equity method results in a higher ROA because of the higher net income under the equity method.
Conclusion 2:	Compared to the acquisition method, the equity method results in a higher ROA because of the smaller level of total assets under the equity method.

He also makes the following statements regarding the acquisition method and equity method:

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In addition, Valley has always wanted to pursue its goal of vertical integration by expanding its scope of operations to include the manufacturing of airline parts for its own airplanes. Therefore, it established a subsidiary, Mountain Air Parts (Mountain), in Switzerland on January 1, 2008. Switzerland was chosen as the location for economic and geographical diversification reasons. Mountain will operate as a self-contained, independent subsidiary. Local management in Switzerland will make the majority of operating, financing, and investing decisions.

The Swiss franc (CHF) is the official currency in Switzerland. On January 1, 2008, the USD/CHF exchange rate was 0.77. At December 31, 2008, the exchange rate had changed to 0.85 USD/CHF. The average exchange rate in 2008 was 0.80 USD/CHF. In its first year of operations, Mountain paid no dividends and no taxes. Mountain uses the FIFO assumption for its flow of inventory.

Moutain Air Parts

Balance Sheet

(in CHF thousands)	12/31/2008	1/1/2008

Assets		
Cash and accounts receivable	**600**	400
Inventory	**500**	500
Property, plant, and equipment	**600**	700
Total assets	**1,700**	**1,600**
Liabilities and equity		
Accounts payable	**200**	100
Long-term debt	**100**	200
Common stock	**1,300**	1,300
Retained earnings	**100**	0
Total liabilities and owner's equity	**1,700**	**1,600**

Mountain Air Parts

Income Statement for 2008

(in CHF thousands)

Sales	**7,000**
COGS	**(6,800)**
Depreciation	**(100)**
Net income	**100**

Using the appropriate method of translation, the amount of total assets reported on Mountain's balance sheet at the end of 2008 is *closest* to:

A) $1,325.
B) $1,375.
C) $1,445.

Question #35 of 60

Question ID: 692343

Jason Bennett is an analyst for Valley Airlines (Valley), a U.S. firm. Valley owns a stake in Southwest Air Cargo (Southwest), also a U.S. firm. The two firms have had a long-standing relationship. The relationship has become even closer because several of Valley's top executives hold seats on Southwest's Board of Directors.

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Immediately prior to the acquisition, Valley's current asset balance and total equity were $96 million and $80 million,

respectively. Southwest's current assets and total equity were $32 million and $16 million, respectively.

While analyzing the use of the equity method versus the acquisition method, Bennett calculates the return on assets (ROA) ratio. He arrives at two conclusions:

Conclusion 1:	Compared to the acquisition method, the equity method results in a higher ROA because of the higher net income under the equity method.
Conclusion 2:	Compared to the acquisition method, the equity method results in a higher ROA because of the smaller level of total assets under the equity method.

He also makes the following statements regarding the acquisition method and equity method:

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The Swiss franc (CHF) is the official currency in Switzerland. On January 1, 2008, the USD/CHF exchange rate was 0.77. At December 31, 2008, the exchange rate had changed to 0.85 USD/CHF. The average exchange rate in 2008 was 0.80 USD/CHF. In its first year of operations, Mountain paid no dividends and no taxes. Mountain uses the FIFO assumption for its flow of inventory.

Moutain Air Parts

Balance Sheet

(in CHF thousands)	12/31/2008	1/1/2008
Assets		
Cash and accounts receivable	**600**	400
Inventory	**500**	500
Property, plant, and equipment	**600**	700
Total assets	**1,700**	**1,600**
Liabilities and equity		
Accounts payable	**200**	100
Long-term debt	**100**	200
Common stock	**1,300**	1,300
Retained earnings	**100**	0

Total liabilities and owner's equity	**1,700**	**1,600**

Mountain Air Parts

Income Statement for 2008

(in CHF thousands)

Sales	**7,000**
COGS	**(6,800)**
Depreciation	**(100)**
Net income	**100**

Using the appropriate method of translation, the translation gain (loss) for the year ended 2008 is *closest* to:

A) $99.

B) $104.

C) $109.

Question #36 of 60

Question ID: 692344

Jason Bennett is an analyst for Valley Airlines (Valley), a U.S. firm. Valley owns a stake in Southwest Air Cargo (Southwest), also a U.S. firm. The two firms have had a long-standing relationship. The relationship has become even closer because several of Valley's top executives hold seats on Southwest's Board of Directors.

Valley acquired a 45% ownership stake in Southwest on December 31, 2007. Acquisition of the ownership stake cost $9 million and was paid in cash. Valley's stake in Southwest is such that management can account for the investment using either the equity method or the acquisition method. While Valley's management desires to fairly represent the firm's operating results, they have assigned Bennett to assess the impact of each method on reported financial statements.

Immediately prior to the acquisition, Valley's current asset balance and total equity were $96 million and $80 million, respectively. Southwest's current assets and total equity were $32 million and $16 million, respectively.

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Conclusion 1:	Compared to the acquisition method, the equity method results in a higher ROA because of the higher net income under the equity method.
Conclusion 2:	Compared to the acquisition method, the equity method results in a higher ROA because of the smaller level of total assets under the equity method.

He also makes the following statements regarding the acquisition method and equity method:

Statement 1:	The applicability of both methods is identical under U.S. GAAP and IFRS.
Statement 2:	Both methods report the same net income on the parent's consolidated income statement.
Statement 3:	Both methods report the same equity on the parent's consolidated balance sheet.

In addition, Valley has always wanted to pursue its goal of vertical integration by expanding its scope of operations to include the manufacturing of airline parts for its own airplanes. Therefore, it established a subsidiary, Mountain Air Parts (Mountain), in Switzerland on January 1, 2008. Switzerland was chosen as the location for economic and geographical diversification reasons. Mountain will operate as a self-contained, independent subsidiary. Local management in Switzerland will make the majority of operating, financing, and investing decisions.

The Swiss franc (CHF) is the official currency in Switzerland. On January 1, 2008, the USD/CHF exchange rate was 0.77. At December 31, 2008, the exchange rate had changed to 0.85 USD/CHF. The average exchange rate in 2008 was 0.80 USD/CHF. In its first year of operations, Mountain paid no dividends and no taxes. Mountain uses the FIFO assumption for its flow of inventory.

Moutain Air Parts

Balance Sheet

(in CHF thousands)	12/31/2008	1/1/2008
Assets		
Cash and accounts receivable	**600**	400
Inventory	**500**	500
Property, plant, and equipment	**600**	700
Total assets	**1,700**	**1,600**
Liabilities and equity		
Accounts payable	**200**	100
Long-term debt	**100**	200
Common stock	**1,300**	1,300
Retained earnings	**100**	0
Total liabilities and owner's equity	**1,700**	**1,600**

Mountain Air Parts

Income Statement for 2008

(in CHF thousands)	
Sales	**7,000**
COGS	**(6,800)**
Depreciation	**(100)**
Net income	**100**

....

For this question only, assume that Mountain is operating in a highly inflationary environment. Which of the following statements is *least* correct? Mountain's:

A) nonmonetary assets and nonmonetary liabilities are adjusted for inflation in accordance with U.S. GAAP.

B) functional currency is the U.S. dollar.

C) financial statements are adjusted for inflation, and the net purchasing power gain or loss is recognized in the income statement in accordance with IFRS.

Question #37 of 60

Question ID: 692364

Questions 97-102 relate to Alertron.

Alertron is a pharmaceutical company with approximately $3.5 billion in annual sales that specializes in the development, manufacturing, and marketing of neurology and oncology drug therapies. The firm is seeking to achieve more rapid growth, and Alertron's executive management team feels that the company can grow faster by making acquisitions than it can by trying to grow organically. As a result, management asks the firm's Director of Strategic Planning, Kanna Ozer, CFA, to analyze potential alternatives. At Alertron's next executive management team meeting, Ozer presents the report shown in Exhibit 1 concerning four potential acquisition targets:

Exhibit 1: Report 1-Description of Potential Acquisition Targets

Potential Target	*Potential Acquisition Description*
BriscoePharm	Firm develops, manufactures, and markets prescription drugs for humans and animals. BriscoePharm has annual sales of $1.2 million, but only certain BriscoePharm drugs are attractive cash flow generators.
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Six other firms	Each have 3% market share

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Based on Ozer's description of potential acquisition targets, which form of integration and type of merger would *best* describe the transaction if Alertron tried to acquire Escarigen?

	Form of integration	Type of merger
A)	Statutory	Horizontal
B)	Subsidiary	Horizontal
C)	Subsidiary	Vertical

Question #38 of 60

Question ID: 692365

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Based on the information in Exhibit 2, which of the following statements concerning the transaction characteristics of the potential mergers with Alertron is *most accurate*?

A) Purchasing Escarigen is likely to reduce Alertron's financial leverage.

B) Carideo would likely avoid paying corporate taxes in the potential deal with Alertron.

C) BriscoePharm's shareholders would likely be required to approve the deal with Alertron before any proposed deal is completed.

Question #39 of 60

Question ID: 692378

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Which of the following *best* satisfies Kumar's request to identify a pair of defense mechanisms that consist of a pre-offer and a post-offer defense?

	Pre-offer defense mechanism	Post-offer defense mechanism
A)	Poison put	Fair price amendment
B)	Greenmail	Restricted voting rights
C)	Supermajority voting provision	Leveraged recapitalization

Question #40 of 60

Question ID: 692368

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Using Ozer's estimates of the cost reduction synergies, the gain that would accrue to Carideo's shareholders as a result of the merger with Alertron is *closest* to:

A) $108.5 million.

B) $455.6 million.

C) $514.2 million.

Question #41 of 60

Question ID: 692369

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Based on each firm's forecasts of the estimated NPV of synergies from a merger between Alertron and Carideo, what payment method is each firm *likely* to prefer in the deal?

A) Both firms prefer a cash deal.

B) Only Alertron prefers a cash deal.

C) Only Carideo prefers a cash deal.

Question #42 of 60

Question ID: 692379

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What would be the increase in the Herfindahl-Hirschman Index (HHI) as a result of a merger between Alertron and Carideo, and the *most likely* reaction by regulators to the merger?

Increase in the HHI	Probable response by regulators

A) 75 No antitrust challenge

B) 300 No antitrust challenge

C) 300 Potential antitrust challenge

Question #43 of 60

Question ID: 692349

Questions 103-108 relate to Jacob Marlinton.

Jacob Marlinton, CFA, works for Bantanaya Modros, Inc. (BATNM), a small, independent brewery in the United States. The company was originally privately owned and all profits were distributed to the ownership group at the end of every year. Last year, however, the company wished to expand its operations and used the proceeds of an IPO to fund a bottling plant and expand its distribution network.

At this year's annual general meeting, the board faced several questions about its intended dividend policy in the future. The CEO is currently in favor of a residual policy, which closely matches the policy before the IPO. He believes that a residual dividend policy will have the following two benefits:

1. The policy should boost the company's share price as it will provide a stable long-term dividend.
2. The policy prioritizes investing in positive NPV projects ahead of considering a reduction in dividends.

Marlinton has been asked to calculate the dividend for 2016 if a residual dividend policy is adopted, given capital expenditure levels in the two scenarios in Exhibit 1.

Exhibit 1: Capital Expenditure Levels

Scenario I
The company further expands operations with the opening of a restaurant/brewery. The estimated total required capital expenditure for this plan is $28 million. The project would be financed with a mix of debt and equity in line with the BATNM's target debt and equity weightings. If earnings are not available, the shortfall would be financed with debt, leading to what is expected to be a temporary deviation from the target capital structure.
Scenario II
No significant expansion undertaken. The only capital expenditure would be the replacement of existing equipment. Existing brewing equipment would be sold for $2.2 million and replaced with new equipment costing $3.8 million. The old equipment is three years old and is being depreciated over five years with no salvage value in the financial statements. BATNM received 100% of the cost of the old machine as a tax deduction when it was purchased three years ago because the company is located in a designated tax enterprise zone. The new equipment would similarly qualify for a 100% deduction allowance in the year of purchase. Note that as a result of the replacement of equipment, inventory levels would increase by $200,000.

To help with the calculation, Marlinton has obtained a current summary balance sheet for the firm and a forecasted summary income statement for the year ahead, as shown in Exhibit 2. Marlinton assumes that the current balance sheet levels of debt and equity reflect BATNM's target capital structure. The tax rate for the company is 35%.

Exhibit 2: Summarized Financial Statements (current/forecasted)

Current Balance Sheet

as of 1 January 2016

Assets	($ Thousands)	
Current assets		
Inventory	51,307	
Accounts receivable	36,860	
Cash	76,402	
Other	42,893	
Total		**207,462**
Long-lived assets		
PPE		381,569
Goodwill		3,683
Other		12,447
Total		**605,161**
Liabilities and equity		
Current liabilities		
Accounts payable	22,576	
Short-term debt	120	
Other	74,539	
Total		**97,235**
Long-term liabilities		
Long-term debt		74,953
Other		7,606
Total		**179,794**
Equity		
Common stock		200,458
Additional paid in capital		224,909
Total liabilities and equity		**605,161**

Forecasted Income Statement

Year Ended 31 December 2016

	($ Thousands)
Revenue	248,303
Operating income	40,502

Net income	26,034

Marlinton is concerned that any dividend policy adopted should allow BATNM to stay closely aligned with its target capital structure. He is concerned that any significant increase in debt would lead to a sharp increase in the cost of equity. He has prepared an analysis to test this effect using Modigliani and Miller's theory of capital structure in a world with taxes.

In his analysis, Marlinton assumes that the cost of equity if BATNM was all equity financed would be 15%. He intends to work out the increase in the current cost of equity if $40 million of debt at a cost of 8% was added to the current balance sheet. In his analysis, he intends to also assume that the amount of equity remains constant. Marlinton recognizes that most of the assets of the company (e.g., brewing equipment) are tangible, and, hence, the cost of financial distress will be lower for BATNM relative to companies with mostly intangible assets.

Marlinton believes that maintaining the target capital structure is much more important than dividend policy. He thinks that the company should finance its projects by giving the highest preference to the method with the least potential information content and the lowest preference to the form with the greatest.

....

Regarding the CEO's comments regarding the benefits of a residual dividend policy, Marlinton will *most likely* conclude that:

A) both are correct.

B) only benefit 1 is accurate.

C) only benefit 2 is accurate.

Question #44 of 60

Question ID: 692381

Jacob Marlinton, CFA, works for Bantanaya Modros, Inc. (BATNM), a small, independent brewery in the United States. The company was originally privately owned and all profits were distributed to the ownership group at the end of every year. Last year, however, the company wished to expand its operations and used the proceeds of an IPO to fund a bottling plant and expand its distribution network.

At this year's annual general meeting, the board faced several questions about its intended dividend policy in the future. The CEO is currently in favor of a residual policy, which closely matches the policy before the IPO. He believes that a residual dividend policy will have the following two benefits:

1. The policy should boost the company's share price as it will provide a stable long-term dividend.
2. The policy prioritizes investing in positive NPV projects ahead of considering a reduction in dividends.

Marlinton has been asked to calculate the dividend for 2016 if a residual dividend policy is adopted, given capital expenditure levels in the two scenarios in Exhibit 1.

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financed with a mix of debt and equity in line with the BATNM's target debt and equity weightings. If earnings are not available, the shortfall would be financed with debt, leading to what is expected to be a temporary deviation from the target capital structure.

Scenario II

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....

The expected 2016 dividend under a residual dividend policy and scenario I is *closest* to:

A) $3,000,000.
B) $2,230,000.
C) zero.

Question #45 of 60

Question ID: 692345

Question #45 of 60

Jacob Marlinton, CFA, works for Bantanaya Modros, Inc. (BATNM), a small, independent brewery in the United States. The company was originally privately owned and all profits were distributed to the ownership group at the end of every year. Last year, however, the company wished to expand its operations and used the proceeds of an IPO to fund a bottling plant and expand its distribution network.

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....

The initial outlay to be included in Marlinton's NPV calculation for the project in scenario II is *closest* to:

A) $3,250,000

B) $2,900,000

C) $2,570,000

Question #46 of 60

Question ID: 692346

Jacob Marlinton, CFA, works for Bantanaya Modros, Inc. (BATNM), a small, independent brewery in the United States. The company was originally privately owned and all profits were distributed to the ownership group at the end of every year. Last year, however, the company wished to expand its operations and used the proceeds of an IPO to fund a bottling plant and expand its distribution network.

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....

Using Marlinton's assumptions in his capital structure analysis, after the additional debt of $40 million, the cost of equity would *most likely* be:

A) 16.2%
B) 17.7%
C) 18.1%

Question #47 of 60

Question ID: 692347

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....

Marlinton's assumptions regarding BATNM's costs of financial distress are *most likely*:

A) Correct.

B) incorrect as the costs of financial distress are related to debt levels and not related to assets.

C) incorrect as the costs of financial distress are higher if the company's balance sheet is made up of mostly tangible assets.

Question #48 of 60

Question ID: 692348

Jacob Marlinton, CFA, works for Bantanaya Modros, Inc. (BATNM), a small, independent brewery in the United States. The company was originally privately owned and all profits were distributed to the ownership group at the end of every year. Last year, however, the company wished to expand its operations and used the proceeds of an IPO to fund a bottling plant and expand its distribution network.

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....

Marlinton's suggested method of financing projects is *most likely* to be referred to as:

A) the pecking order theory.
B) the static trade-off theory.
C) Modigliani and Miller proposition II.

Question #49 of 60

Question ID: 692372

Questions 109-114 relate to Trailblazer, Inc.

Louise Valentine, CFA, is analyzing the financial information of Trailblazer, Inc., a company in the retail sector. She is preparing to write a report on her findings. Valentine is considering various valuation approaches and is convinced that a dividend discount model (DDM) would be among the best choices in this case. She notes that Trailblazer does not vary its dividend payments significantly from year to year.

In preparing to estimate a suitable required rate of return on equity for Trailblazer, Valentine notes that the current T-bill rate is 3.5% and that the yield on the company's 10-year bonds is 7.25% while the yield on a 10-year Treasury bond is 4.4%

3.5% and that the yield on the company's 10-year bonds is 7.25% while the yield on a 10-year Treasury bond is 4.4%. Additionally, Valentine estimates that the appropriate equity risk premium in excess of the company's cost of debt is 3%. Valentine estimates that average dividend yield for the S&P 500 (the market proxy) is 2.1% and a consensus long-term EPS growth rate of 3.5% is forecast for S&P 500 index.

Valentine also gathers the information shown in Exhibit 1.

Exhibit 1: Trailblazer, Inc. Multifactor Sensitivities (APT)

Factor	*Factor Risk Premium*	*Trailblazer, Inc. Factor Sensitivities*
1	1.91%	0.81
2	1.22%	−0.45
3	3.47%	0.24
4	4.15%	0.74

In her report, Valentine makes the following statements about Trailblazer dividends:

Statement 1: Trailblazer is expected to pay a dividend next year and will continue to do so for the foreseeable future.

Statement 2: The required rate of return for Trailblazer stock will likely exceed the growth rate of its dividends.

Statement 3: Trailblazer is in a mature sector of its industry, and accordingly, I expect dividends to decline at a constant rate of 4% indefinitely.

In speaking to a colleague at her firm, Valentine makes the following additional statements after her report is released:

Statement 4: Trailblazer has a 10-year history of paying regular quarterly dividends.

Statement 5: Over a recent 10-year period, Trailblazer has experienced one 3-year period of consecutive losses and another period of two annual losses in a row but has been extremely profitable in the remaining five years.

Valentine is concerned with some of the inputs for estimating the cost of equity for other companies that she follows. Based on her research, she makes the following statements:

Statement 6: We have used historical equity risk premium as input into the CAPM. However, we should adjust the said equity risk premium because it includes some unfavorable surprises in productivity declines and higher inflation due to oil price shocks.

Statement 7: When estimating beta of a private company using a public company peer, the private company beta should be adjusted for the difference in leverage between the public company and the private company, as well as the difference in their respective sizes.

Valentine is also analyzing the stock of Farwell, Inc. Farwell shares are currently trading at $48 based on current earnings of

$4 and a current dividend of $2.60. Dividends are expected to grow at 5% per year indefinitely. The risk-free rate is 3.5%, the market risk premium is 4.5%, and Farwell's beta is estimated to be 1.2.

Based on the APT model and the bond yield plus risk-premium (BYPRP) method, the discount rate Valentine should use in valuing the equity of Trailblazer is *closest* to:

	Rate based on APT	Rate based on BYPRP
A)	8.40%	10.25%
B)	4.90%	10.25%
C)	4.90%	7.25%

Question #50 of 60

Question ID: 692370

Louise Valentine, CFA, is analyzing the financial information of Trailblazer, Inc., a company in the retail sector. She is preparing to write a report on her findings. Valentine is considering various valuation approaches and is convinced that a dividend discount model (DDM) would be among the best choices in this case. She notes that Trailblazer does not vary its dividend payments significantly from year to year.

In preparing to estimate a suitable required rate of return on equity for Trailblazer, Valentine notes that the current T-bill rate is 3.5% and that the yield on the company's 10-year bonds is 7.25% while the yield on a 10-year Treasury bond is 4.4%. Additionally, Valentine estimates that the appropriate equity risk premium in excess of the company's cost of debt is 3%. Valentine estimates that average dividend yield for the S&P 500 (the market proxy) is 2.1% and a consensus long-term EPS growth rate of 3.5% is forecast for S&P 500 index.

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In her report, Valentine makes the following statements about Trailblazer dividends:

Statement 1:	Trailblazer is expected to pay a dividend next year and will continue to do so for the foreseeable future.
Statement 2:	The required rate of return for Trailblazer stock will likely exceed the growth rate of its dividends.

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Statement 3:	Trailblazer is in a mature sector of its industry, and accordingly, I expect dividends to decline at a constant rate of 4% indefinitely.

In speaking to a colleague at her firm, Valentine makes the following additional statements after her report is released:

Statement 4:	Trailblazer has a 10-year history of paying regular quarterly dividends.
Statement 5:	Over a recent 10-year period, Trailblazer has experienced one 3-year period of consecutive losses and another period of two annual losses in a row but has been extremely profitable in the remaining five years.

Valentine is concerned with some of the inputs for estimating the cost of equity for other companies that she follows. Based on her research, she makes the following statements:

Statement 6:	We have used historical equity risk premium as input into the CAPM. However, we should adjust the said equity risk premium because it includes some unfavorable surprises in productivity declines and higher inflation due to oil price shocks.
Statement 7:	When estimating beta of a private company using a public company peer, the private company beta should be adjusted for the difference in leverage between the public company and the private company, as well as the difference in their respective sizes.

Valentine is also analyzing the stock of Farwell, Inc. Farwell shares are currently trading at $48 based on current earnings of $4 and a current dividend of $2.60. Dividends are expected to grow at 5% per year indefinitely. The risk-free rate is 3.5%, the market risk premium is 4.5%, and Farwell's beta is estimated to be 1.2.

....

The forward-looking estimate of average equity risk premium (based on the S&P 500 index as market proxy) is *closest* to:

A) 1.2%.

B) 2.1%.

C) 5.6%.

Question #51 of 60

Question ID: 692374

Louise Valentine, CFA, is analyzing the financial information of Trailblazer, Inc., a company in the retail sector. She is preparing to write a report on her findings. Valentine is considering various valuation approaches and is convinced that a dividend discount model (DDM) would be among the best choices in this case. She notes that Trailblazer does not vary its dividend payments significantly from year to year.

In preparing to estimate a suitable required rate of return on equity for Trailblazer, Valentine notes that the current T-bill rate is 3.5% and that the yield on the company's 10-year bonds is 7.25% while the yield on a 10-year Treasury bond is 4.4%. Additionally, Valentine estimates that the appropriate equity risk premium in excess of the company's cost of debt is 3%. Valentine estimates that average dividend yield for the S&P 500 (the market proxy) is 2.1% and a consensus long-term EPS growth rate of 3.5% is forecast for S&P 500 index.

Valentine also gathers the information shown in Exhibit 1.

Exhibit 1: Trailblazer, Inc. Multifactor Sensitivities (APT)

Factor	*Factor Risk Premium*	*Trailblazer, Inc. Factor Sensitivities*
1	1.91%	0.81
2	1.22%	−0.45
3	3.47%	0.24
4	4.15%	0.74

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How many of the first three statements Valentine made concerning Trailblazer's dividends are consistent with assumptions of the Gordon growth model (GGM)?

A) None.

B) Two.

C) Three.

Question #52 of 60

Question ID: 692373

Louise Valentine, CFA, is analyzing the financial information of Trailblazer, Inc., a company in the retail sector. She is preparing to write a report on her findings. Valentine is considering various valuation approaches and is convinced that a dividend discount model (DDM) would be among the best choices in this case. She notes that Trailblazer does not vary its dividend payments significantly from year to year.

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....

Do statements 4 and 5 support the decision by Valentine to use a dividend discount model?

A) Both statements support the use of DDM.

B) Only Statement 4 supports the use of DDM.

C) Only Statement 5 supports the use of DDM.

Question #53 of 60

Question ID: 692371

Louise Valentine, CFA, is analyzing the financial information of Trailblazer, Inc., a company in the retail sector. She is preparing to write a report on her findings. Valentine is considering various valuation approaches and is convinced that a dividend discount model (DDM) would be among the best choices in this case. She notes that Trailblazer does not vary its dividend payments significantly from year to year.

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$4 and a current dividend of $2.60. Dividends are expected to grow at 5% per year indefinitely. The risk-free rate is 3.5%, the market risk premium is 4.5%, and Farwell's beta is estimated to be 1.2.

Are statements 6 and 7 correct?

A) Both statements are incorrect.

B) Only Statement 6 is incorrect.

C) Only Statement 7 is incorrect.

Question #54 of 60

Question ID: 692375

Louise Valentine, CFA, is analyzing the financial information of Trailblazer, Inc., a company in the retail sector. She is preparing to write a report on her findings. Valentine is considering various valuation approaches and is convinced that a dividend discount model (DDM) would be among the best choices in this case. She notes that Trailblazer does not vary its dividend payments significantly from year to year.

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Valentine also gathers the information shown in Exhibit 1.

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....

The justified leading and justified trailing P/E ratios of Farwell are *closest* to:

	Justified leading P/E	Justified trailing P/E
A)	16.67	9.42
B)	8.97	17.50
C)	16.67	17.50

Question #55 of 60

Question ID: 691515

Questions 115-120 relate to Tom Vadney.

Tom Vadney, CFA, is president and CEO of Vadney Research and Advisors (VRA), a large equity research firm that specializes in providing international investment and advisory services to global portfolio managers. He has a staff of five junior analysts and three senior analysts covering industries and firms across the Americas, Europe, and Asia-Pacific regions.

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In a recent meeting with an institutional portfolio manager, Vadney is asked to review the differences between U.S. GAAP and International Financial Reporting Standards (IFRS) as well as provide a comprehensive industry analysis for the telecommunications sector in Europe and the Asia-Pacific region. Vadney asks Maria Mnoyan, a senior analyst covering the sector, to research the requested information for the client meeting.

Prior to the meeting, Vadney and Mnoyan meet to prepare for the client presentation. They first discuss differences between U.S. GAAP and IFRS. Mnoyan states that although there will be increasing convergence between the two accounting standards, one major difference currently is that IFRS permits either the "partial goodwill" or "full goodwill" method to value goodwill and a noncontrolling interest under the acquisition method, U.S. GAAP requires the full goodwill method. Vadney adds that U.S. GAAP requires equity method accounting for joint ventures, while under IFRS proportionate consolidation is preferred, but the equity method is permitted.

Mnoyan presents the forecast prepared by three junior analysts for Prime Telco. Adams, the first analyst, expects volume growth of 4%, a sales price increase of 2%, and an input price increase of 3%. Analyst Baste's corresponding forecasts are 2%, 5%, and 4%. Finally, analyst Cairns's forecasts are 1% for volume growth, 4% for sales price growth, and 5% for input price growth. Prime's current revenues and COGS are $121 million and $89 million, respectively.

Mnoyan firmly believes that investing in companies located in developing countries provides strong return prospects as the growth rate in labor productivity increases through technological change and increases in capital.

For example, Mnoyan considers Dien Thoai Corporation, a rapidly growing telecommunication firm in an emerging market country. Dien Thoai is likely to be an acquisition target given the global ambitions of larger firms in developed markets. Mnoyan is interested in calculating the present value of growth opportunities (PVGO) for Dien Thoai. She proposes dividing the last dividend paid by Dien Thoai by the required rate of return to find the value of Dien Thoai's assets in place, and then subtracting this from fundamental value to find PVGO.

Dien Thoai's dividend yield based on the most recent dividend paid is 5%. Dividends and earnings are expected to grow 12% next year, but that rate is expected to decrease linearly over the next six years to a long-term rate of 3% per year.

Are Mnoyan and Vadney correct about differences between U.S. GAAP and IFRS?

A) Both are correct.
B) Only Mnoyan is correct.
C) Only Vadney is correct.

Question #56 of 60

Question ID: 692380

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Dien Thoai's dividend yield based on the most recent dividend paid is 5%. Dividends and earnings are expected to grow 12% next year, but that rate is expected to decrease linearly over the next six years to a long-term rate of 3% per year.

Which analyst is *most likely* to forecast an improvement in gross margin for Prime Telco?

A) Adams
B) Baste
C) Cairns

Question #57 of 60

Question ID: 691510

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Mnoyan's description of the growth potential of developing countries is *best* described as the:

A) classical growth theory.
B) neoclassical growth theory.
C) endogenous growth theory.

Question #58 of 60

Question ID: 691548

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....

What adjustment to her calculation method does Mnoyan need to make to correctly calculate PVGO? The value of assets in place is given by:

A) the previous dividend multiplied by one plus the sustainable growth rate, divided by the required rate of return.

B) earnings divided by the required rate of return.

C) earnings, divided by the required rate of return minus the sustainable growth rate.

Question #59 of 60

Question ID: 691551

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The required rate of return on Dien Thoai stock implied in its current market price is *closest* to:

A) 9.5%

B) 10.8%.

C) 11.3%.

Question #60 of 60

Question ID: 691550

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....

Which of the following is NOT a strength of multistage Dividend Discount Models?

A) Models can be used either in forward or reverse to identify values given assumptions of growth and required return or to derive required returns and projected growth rates implied by market prices.

B) Models are straightforward in the relationship between assumptions and resulting estimates of value, allowing the analyst to review all the assumptions built into the models and to consider the impact of different assumptions.

C) Models are sensitive to assumptions of growth, allowing variability in potential values.